COLUMBIA LAW REVIEW.

VOL. VIII. DECEMBER, 1908. No. 8

SOME NEW ASPECTS OF PARTNERSHIP BANKRUPTCY UNDER THE ACT OF 1898.

In his posthumous work on "The Origin, Growth and Function of Law," Mr. James C. Carter ventured into the dangerous realm of definition by asserting that legislation is "law consciously enacted by men," [1]—but with characteristic caution added that some "qualification is needed."

If by conscious enactment is meant any foreknowledge by statute-lawmakers of the logically necessary results of the words they use, legal history is filled with examples that require serious qualification of the definition suggested; and perhaps there is no better instance of its incompleteness than the ten-year history of subdivisions *a* and *f* of the fifth section of the present Bankruptcy Act.

It is common knowledge that out of the blunt words of subdivision *a*,—that "a partnership * * * may be adjudged a bankrupt" has arisen the doctrine of partnership entity;—while out of both subdivision *a* and the opening words of subdivision *f* that

"the net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts,"—

have grown conflicting decisions illustrative not only of the legislative lack of consciousness, but of that inherent conservatism of the Bar which always delays (and sometimes defeats) the full effect of any new statutory declaration.

It is often interesting to note the origin of phrases which are the small change of literature, and "partnership entity" is now a legal commonplace. For it the profession seems to be indebted to

[1] P. 182.

Judge Thomas of the Eastern District of New York, and Mr. Lowell, whose work on Bankruptcy was published in 1899.

Within a few months after the present statute became operative Judge Thomas decided *Chemical Bank* v. *Meyer*,[2] and in his opinion[3] said that the language of the Act seemed to show that Congress had "endowed all partnerships with something of the nature of a separate and distinct *entity*." A few months later when Mr. Lowell published his book this case was the only reported decision on subdivision *a*, and he prophetically declared that although the fifth section of the new Act was "very similar to the corresponding section of the Act of 1867," yet there was "one important addition which seems to recognize the commercial view of the partnership as a separate *entity*. This will modify the old law in an important respect."

Despite the prompt recognition by the Bar of a legal novelty in Section five I have found no evidence that the framers of the Act attached any importance to the form of words they used.

It seems plain now that the difference between the brief declaration that a partnership may be adjudged a bankrupt and the language of the 36th Section of the Act of 1867,—wherein all the provisions regarding partnership bankruptcy are prefaced by the words "where two or more persons who are partners in trade shall be adjudged bankrupt,"—should be apparent upon cursory reading. Yet Section five in its present shape was reported to the House of Representatives by the appropriate committee on April 13, 1896, and is said to have been modeled upon the Bill so long urged by Mr. Torrey, who is justly looked upon as the father of our present system. Mr. Lowell declares that the idea of rendering a partnership as such liable to the operation of the statute had been conceived by his father (the late Judge John Lowell of Massachusetts), who as early as 1884 had drafted a scheme of bankruptcy. But it does not appear that Mr. Torrey availed himself of Judge Lowell's efforts or even knew of them. Section five was never discussed in any reported transaction of either House or Senate and although Mr. Torrey spoke before numerous business associations in favor of the Bill and submitted to cross-examination regarding many of its details, a reading of all the pamphlets on the subject I have been able to discover does not reveal that prior to the passage of the Act anyone had observed or

[2](1899) 92 Fed. 896.
[3]At p. 899.

objected that the proposed statute made out of an association of partners an entirely new, separate and distinct "person," *i. e.*, the partnership entity.

The *Meyer* Case[4] therefore opened the discussion of a wholly novel question, and the way it is treated in the opinions of both Judge Thomas and the Appellate Court[5] shows, I think, an unusual readiness on the part of those courts to accept and enforce a new doctrine necessarily flowing from words authoritatively laid before the profession without discussion and without introduction. Yet Judge Thomas voiced misgivings characteristic of an experienced lawyer obliged to set up new standards and work out new results in a portion of the law already explored and marked by familiar beacons.

Thus he said[6] that "the plain language of the statute wars against its acknowledged object, to discharge debtors, as well as against the essential nature of a partnership," for partnership is "but the relation which arises from the agreement of certain persons to combine their property, labor, and skill in business for the purposes of profit." Accordingly, the partnership cannot "commit an act of bankruptcy unless one or more individuals composing the partnership" commit an act which is "tantamount to the partnership itself" doing so. And since this is the necessary course of business it did not seem to him "practical to give a partnership such personality, nor to administer its affairs without a contemporaneous administration of the estate of at least one of the partners;"—because it is "difficult to conceive of a partnership, although it be regarded as a person, being adjudged bankrupt" unless one or more of the partners be at the same time so adjudged.

As Judge Thomas in this case had before him the familiar figure of one partner he felt able to proceed, even though this natural person was accompanied by the new and somewhat terrifying presence of a partnership entity created by statute; and the practice of joining the partnership with some of the partners has received full acceptance, as may be seen in the opinion of the Court of Appeals for the Seventh Circuit,[7] and the cases there enumerated.

Yet despite the prompt partial acceptance of the new doctrine by most Courts, the *Meyer* decision itself contained in the doubt

[4] *Supra.*
[5] *In re* Meyer (1899) 98 Fed. 976.
[6] At p. 899.
[7] *In re* Stein & Co. (1904) 127 Fed. 547.

expressed as to the possibility of adjudicating a partnership without contemporaneously adjudicating the partner,—something capable of emasculating subdivision *a;* and the reports show that most Judges were not ready to wholly divorce the partnership personality from the person of the partner.

If all the partners of a firm are bankrupt the firm itself is almost necessarily bankrupt,—but if the firm be a person in the eye of the law that artificial person must have the faculty of becoming bankrupt without any reference to the individual property, poverty or wealth of the natural persons composing it. This idea was too revolutionary to receive immediate acceptance, and in *In re Blair*[8] the Southern District of New York, when the statute was scarcely a year old, held that:

"No doubt a firm is sometimes said to be insolvent when only a deficiency of joint assets is meant. But as each partner is liable *in solido* for the debts of the company, so that they are debts of each individual member as much and as truly as they are debts of the firm, a partnership cannot with strictness be said to be insolvent while any one of the partners is able to pay all the firm's liabilities."[9]

Bankruptcy without insolvency is possible, but extremely rare; and if the test of partnership insolvency were to remain unchanged subdivision *a* would in practice be nearly lifeless. It would logically follow that creditors might file a petition against a firm and the known partners and yet be defeated by discovering a secret solvent partner who manifested no desire to administer upon the firm's assets or discharge its liabilities;—and this attempt was actually made in *In re Harris.*[10]

The *Blair* Case seems to me convincing evidence of professional conservatism. It was plain enough that Congress had made a partnership as such capable of adjudication. But Congress had not by the letter of the statute changed the test of partnership insolvency which courts had long before created for themselves, and therefore Judge Brown in the *Blair* matter adhered to the old test of insolvency regardless of its effect on the practical administration of law under the new statute. His decision was often followed, and finally approved in a Court of Appeals (Sixth Circuit) in *Vaccaro* v. *Security Bank.*[11]

[8](1900) 99 Fed. 76.
[9]At p. 79.
[10](1899) 108 Fed. 517.
[11](1900) 103 Fed. 436.

The language of this last decision has unfortunately been carried into the text-books, and it is only recently that the Appellate Court for the Eighth Circuit, in *In re Bertenshaw*,[12] has fairly met the issue and plainly declared that because a partnership is a distinct entity, separate from the individuals who compose it, its property and its debts are separate and distinct from the property of its individual members and from their individual debts,—and that the partnership is insolvent under the present Act when the aggregate of the joint property is not sufficient to pay the joint debts. This decision has lately been followed even in the Second Circuit.[13]

It is not yet certain which view will meet with full acceptance, but to me it is clear that only by accepting the *Bertenshaw* decision can the Courts live up to the language of the Act. A partnership being now a person for bankruptcy purposes,—if some of the incidents of adjudication are inappropriate to such artificial personality the same condition has long existed as to corporations; it is also true that one object of bankruptcy proceedings is to relieve debtors, but it is quite as much an object to secure equitable distribution of assets, and the latter procedure is first in order of time. Partners who wish release from liability have an open path before them, but creditors who wish dividends and desire to prevent preferences must act quickly and should not be hampered by nice questions of possible solvency of possible partners. The Legislature builded better than it knew, and the duty of the Courts is to take the statutory words at their full value and not prevent relief by adherence to old definitions that do not square with the result promised by the Act.

The difficulties foreseen in the *Meyer* Case are imaginary rather that real;—I have known of no voluntary petition by a firm entity; and of but one involuntary petition against that entity alone.[14] It is not impossible to conceive of an entity discharge; the fact that it would have no practical value is no reason for keeping the firm out of Court, while personal discharges to all who are adjudicated in partnership proceedings are now of daily occurrence, and any partner not joined or not adjudicated is neither helped nor harmed by the petition[15]—nor should he be,—while any solvent partner who will undertake the liquidation of the firm has his rights secured by the Act itself.

[12] (1907) 157 Fed. 363.
[13] *In re* Solomon & Carvel (1908) 163 Fed. 140.
[14] *In re* Pincus (1906) 147 Fed. 621.
[15] *In re* Pincus, *supra*; *In re* Coe (1907) 157 Fed. 308.

The new language sympathetically interpreted secures to the creditor a prompt seizure of firm assets,—without regard to dead, insane, absent, dormant or secret partners, who as experience shows are commonly used by the active members to harass and obstruct those holding just demands against the firm.

Subdivision *f* presents an interesting and even amusing instance of the effect of taking any principle of law out of the fluid and changing current of judicial opinion and making a statute therefrom. A lawyer reading the subdivision in embryo would doubtless have regarded it as merely declaratory of an existing general rule; but the rule is hardly older than the vexatious and ill-defined exception that where no firm assets exist individual and partnership creditors share *pari passu* in individual property.

Does an act declaratory of a rule of law declare also by implication the established exceptions to that rule? The Second Circuit has found that to engraft the established exception on the statutory declaration would be judicial legislation,—something as abhorrent in theory as frequent in practice.[16] The Third Circuit has accepted the rule and the exception,[17] and the Judges of the Fourth Circuit have looked over both decisions and taken sides with their brothers of the Second without adding much to the discussion of principles.[18]

Judge Francis Lowell's interesting and exhaustive history of the exception[19] seems to me effectually to dispose of any predisposition to maintain it; but the serious legal question remains, —How shall this or any similar statute be interpreted? I venture to think that until codification becomes the rule, and codes of municipal law are to be regarded as merely indicative of general principles, the application of which to special cases rests largely in judicial discretion, a statutory declaration of a rule of conduct should be taken as exclusive and complete, not to be widened or narrowed but by the Legislature, and that therefore the *Janes* decision expresses the only safe rule in modern bankruptcy.

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[16] *In re* Janes (1904) 133 Fed. 912.
[17] Conrader *v.* Cohen (1903) 121 Fed. 801.
[18] Euclid National Bank *v.* Union Trust Co. (1906) 17 Am. B. R. 834.
[19] *In re* Wilcox (1899) 94 Fed. 84.